



THE SECRETARY OF DEFENSE
WASHINGTON, THE DISTRICT OF COLUMBIA



17 SEP 1984

The Honorable William J. Casey
Director, Central Intelligence Agency
7D60 Headquarters Building
Washington, D.C. 20505

28 Sept 84

Dear Bill:

Four years ago the Reagan Administration undertook the challenge of rebuilding America's defenses. It was a task made particularly difficult -- and expensive -- by the previous decade of neglect of America's military capability.

We have made progress, significant progress; but I'm not sure that message has reached the audience that counts -- the American taxpayer. I would appreciate your assistance in spreading that important story. To help you I have enclosed a brief progress report and the answer to nine tough questions on defense.

Sincerely,

Franklin D. Roosevelt

Attachments



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DEPARTMENT OF DEFENSE PROGRESS REPORT

The Challenge

For three and a half years Americans have been investing in the Reagan defense program to redress the neglect of the 1970s and rebuild the defenses necessary to preserve deterrence.

Because the Soviets had conducted an enormous arms buildup while U.S. defense spending decreased 20% during the decade of the 1970's, we inherited a double burden--of allocating funds quickly to restore the readiness of our armed forces while also making long term investments to modernize our obsolete military equipment.

-- Our defense investments added about \$75 billion in constant FY 1985 dollars to the total obligational authority projected for FY 1981-1984 by the Carter Administration.

The Results

Restored Leadership: We are rebuilding the means to defend our vital interests and meet our global commitments. No longer do we hear that America is unable to act decisively, or to offer leadership in the free world.

Personnel Turnaround: Improved pay and benefits, increased training, and a restored sense of pride in wearing the nation's uniform have given us highly qualified, confident servicemen and women, and military units with a high state of morale and discipline.

Improved Military Posture - Our on-going programs are building:

- Readier forces, better able to sustain themselves in combat;
- Nuclear forces modernized to provide a more stable strategic deterrent;
- Modern, well-equipped ground and tactical air forces to maintain the technological edge needed to offset the overwhelming numerical superiority of increasingly sophisticated Soviet armed forces.
- Maritime forces more capable of defending our seallanes throughout the globe;
- Mobility capabilities better able to support our combat units' global transportation needs;

Greater Efficiency: Sweeping reform of defense management is eliminating deep-rooted procurement problems we inherited to ensure we get more for each defense dollar spent.

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Progress Report

PEOPLE: When President Reagan took office, declining recruitment and a massive exodus of experienced personnel from the armed forces led many to claim that the volunteer concept was a failed experiment, that we would have to return to conscription.

Recruiting: In every year since 1981 each military service has met or exceeded its enlistment goal.

-- Last year was the Army's best recruiting year in recent history.

-- Overall, the percentage of recruits holding high school diplomas has climbed from 68% in FY 1980 to an estimated 92% in FY 1984, giving us better educated men and women to operate modern sophisticated technical equipment.

Retention: We have stemmed the tide of the exodus of experienced service personnel.

-- First term reenlistments have jumped by 35% since 1980. Last year, both the Navy and Air Force had record high reenlistment rates -- 68% and 79% respectively.

-- We continue to make investments to maintain retention as the economy improves. The military must train and promote from within; senior personnel cannot be hired off the street. Longer military careers promote stability, reduce training and recruiting costs, and strengthen leadership.

Reserves: Selected reserve strength exceeded one million in 1983 for the first time since 1961 -- an increase of 18% since FY 1980. This not only enhances our readiness to meet a crisis, but also strengthens the bond between the active duty military and the rest of the citizenry.

Training: To ensure our soldiers can be ready on moments' notice, and to challenge the higher caliber soldiers serving us today, we are providing our combat forces with more resources and opportunities for realistic training.

- The Air Force now provides each of its tactical aircrews almost 20 hours of flying time per month -- up from 16 hours in FY 1980 and a low of 13 hours in FY 1978. Navy aircrews now fly almost 23 hours per month.
- Navy ships are now steaming at an average rate of 34.9 days per quarter, up from 32.4 days in FY 1980.
- The Army has increased its rotations to the National Training center from 16 battalions in FY 1982 to 24 this year, giving 50% more troops an opportunity to participate in some of the most realistic training we have ever offered to our soldiers.

STRATEGIC MODERNIZATION: When President Reagan took office our newest long-range bomber was 19 years old. Our newest strategic submarine was 14 years old and did not have missiles capable of destroying hardened Soviet targets. Our land-based missiles were threatened by huge, new, accurate Soviet ICBMs, while our own missiles lacked the accuracy and destructive force we needed for continued deterrence.

Since 1981, this Administration has vigorously pursued a plan for maintaining deterrence by modernizing the nation's aging nuclear forces, while stressing the importance of arms reductions with the Soviet Union. Overall, nearly half of our strategic weapons will be deployed aboard modern systems by the end of the decade.

- Three new Trident submarines are already at sea, a fourth is nearing completion, and seven more are under construction. Four years ago this program was plagued with skyrocketing costs and slipping schedules; now it is back on track.
- The B-1B strategic bomber is now in production. The first squadron of 15 aircraft will enter service in 1986 -- ahead of schedule and, if current trends continue, below cost.
- We have completed five successful tests of the Peacekeeper (MX) missile, and the first deployment is planned for late 1986. Consistent with the recommendations of the bipartisan Scowcroft Commission the Peacekeeper deployment, and future deployment of a new small ICBM, will enhance stability by breaking the Soviets' monopoly on the capability to attack hardened, time-urgent targets.

- We have begun work on a long-term research program to find a way to defend against nuclear ballistic missiles, an effort that offers the greatest promise for security and stability since the dawn of the nuclear age.

CONVENTIONAL MODERNIZATION: In 1981 we faced a major shortfall in weapons and equipment, and much of what we did have was aging and increasingly obsolete compared with new Soviet hardware. Our qualitative edge, which helped to offset the enormous numerical superiority of Soviet forces, had eroded. We have embarked on a long-term modernization program to restore our technological superiority.

Army: We are providing our armored battalions with faster, more lethal and survivable M-1 tanks -- tanks that can fire accurately on the move, day or night. We added 500 M-1s to the FY 1981-1984 procurement plan of the previous Administration; when delivered, they will have increased our FY 1980 tank inventory by 25%.

- To improve our tactical mobility and anti-armor capability, we added 550 more Bradley Fighting Vehicles.

Navy: From a fleet of 479 deployable battle force ships at the end of FY 1980, the Navy's fleet will have grown to 525 ships by the end of FY 1984, and a force of 600 deployable ships, including 15 carriers, by the end of the decade.

- With this expanded fleet we can both meet the challenge posed by the transformation of the Soviet Navy to a "bluewater" force capable of projecting power far beyond Soviet borders, and protect the vital sea lanes we rely on for trade and communication with our allies.

Air Force: Because we are severely outnumbered on the ground our Western Alliance depends heavily on tactical air as a counterweight.

- To maintain our air superiority in the face of major improvements in Soviet and Warsaw Pact air forces, we will have acquired in FY 1981-84 some 700 more modern tactical aircraft for the Air Force, which when delivered will double the FY 1980 inventories of these aircraft.

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- F-15 and F-16 combat effectiveness will also be enhanced by new, more durable and easily maintained engines. Due to tough competition, those engines were purchased at considerably less cost than originally anticipated, will come with impressive warranties, and have provisions for future competition for replacement spares.

Mobility: Since this Administration took office, our mobility capabilities have increased by about 35%. By the end of the decade, airlift capacity will have increased by 80%, sealift by 110% and the amount of prepositioned materiel by 150%.

- Airlift: By the end of the decade we will have added 50 C-5B cargo aircraft and 44 KC-10 tankers to the fleet, and modified 19 commercial aircraft to carry military cargo in an emergency. C-17 cargo aircraft procurement will start later this decade.
- Sealift: We have invested more to improve sealift in the past three years than in all the years since World War II.

READINESS: Increased military compensation, training and materiel funding have dramatically improved the ability of our forces to respond rapidly and effectively in a crisis.

- Operational and Maintenance Support: During FY 1980-1984 we increased funding almost 25% in constant dollars for supplies needed for daily operation and maintenance of our forces.
- Navy ships rated "fully" or "substantially" ready has increased 25 percentage points since Jan 1981.
- Projected FY 1983 mission-capable rates for fighter and attack aircraft are 9 percentage points higher than FY 1980 levels in the Navy and 5 percentage points higher in the Air Force.
- Increases in USAF spare parts stocks for tactical aircraft led to a 60% increase between FY 1981 and FY 1983 in the number of fully supported combat sorties that could be flown in the early phases of a conflict.

SUSTAINABILITY: In 1981, stocks of ammunition and spare parts were dangerously low, inhibiting the "staying power" of our forces in combat.

-- Although building ammunition fuel and equipment stocks is a slow and expensive process, between FY 1983 and FY 1986, stocks of war reserve munitions are projected to grow steadily -- by 14% for the Army, 58% for the Navy, 62% for the Air Force, and 24% for the Marine Corps.

-- Only by the end of the decade, however--with continued funding support from Congress--will we begin to achieve a sustainability posture that fully deters an adversary from beginning aggression in hopes of outlasting us.

MANAGEMENT REFORM: We are modernizing our forces in the most efficient and economical way possible.

Finding the Problems: Dedicated efforts of DoD auditors and other employees have uncovered long-standing management and procurement problems. The new DoD Inspector General's office is coordinating the campaign against waste and inefficiency.

-- During FY 1982 alone -- 18,467 internal audits identified a total potential savings of \$1.6 billion through greater efficiency.

-- The Defense Hot Line has produced thousands of calls and suggestions that are being acted on.

-- During FY 1983 aggressive DoD-Justice prosecution resulted in 657 convictions and \$14 million in fines.

-- Debarments and suspensions of unscrupulous contractors have almost doubled in the past year and quadrupled since 1980.

Solving the Problems:

-- Using a task force approach, the DoD Council on Integrity and Management Improvement (DCIMI), coordinates the implementation of management reform programs and actions.

-- Our Acquisition Improvement Program now focuses on six areas: program stability, multi-year procurement, economic production rates, realistic budgeting, improved support and readiness, and increased competition.

--- Between FY 1982-84 we proposed 38 multi-year programs to Congress; 23 were approved, resulting in an estimated \$3.8 billion savings.

We have submitted 12 new multi-year programs in the FY 1985 budget which should result in a further \$1.1 billion cost avoidance.

- More economic production rates in the FY 1983-84 budgets will save an estimated \$2.6 billion during FY 1982-89.
- Improved Spare Parts Management, involving a DoD inventory of almost 4 million different items, is a complex and massive management challenge. Secretary Weinberger's 10-point program is already working -- revamping old contracts to allow competition, challenging high prices, obtaining refunds, continuing audits, and enhancing competition.
- The DoD IG, just completed the largest spare parts audit in DoD history and confirmed that these reforms are on the mark.
- As one example, the famed stool-cap, whose original four-digit price was challenged by an alert Air Force Sergeant, is now being obtained for 31 cents. We received a full refund and gave the Air Force Sergeant a \$1,100 cash award.
- The same commitment from our DoD employees to identify wasteful practices and solve them is leading to similar reforms of Defense property disposal practices.
- Increasing competition has become a key element of all our reform efforts -- in acquisition as well as spare parts management.
- "Competition Advocates" are now working in all buying commands to challenge all non-competitive purchases. As a result, competition in aircraft spares has tripled. To assure continued competition, new contracts include provisions designed to provide the data necessary to seek second sources of supply in purchasing parts.

FINAL NOTE:

The Reagan Administration has used its defense investments effectively to redress serious deficiencies in our military posture. We are a much more capable and ready

fighting force in 1984--and we are moving toward a more stable conventional and strategic deterrent. But maintaining the military balance, like any other long-term investment, requires a determined and sustained effort.

Calls for retrenchment are once again being heard, even though the defense budget has already borne large reductions in the effort to cut federal deficits (relative to our earlier projections, total defense obligational authority has been cut back \$75 billion in current dollars since FY 1983 alone).

-- The most recent cuts bring the revised FY 1985 budget down to \$297 billion in total defense spending--a reduction of almost \$30 billion in little more than a year's time. Further cuts in defense spending would undermine the progress of the last three years and repeat the "stop and go" spending patterns that have driven up weapon system costs in the past.

If we are allowed to continue on the path we have set, we can look forward to a substantially strengthened defense posture, with far less risk that our adversaries will miscalculate our will and our capabilities to preserve the peace.

S. Jones/OASD-PA(DES)/August 1984/697-8191

Nine Tough Questions on Defense

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Q. I understand the need for a strong defense, but the prices the Pentagon pays for spare parts are a scandal. How can you explain the \$400 claw hammer, or the \$1,100 plastic stool cap? Has the Defense Department put anyone in jail, gotten refunds on these absurd prices, or suspended business with these dishonest contractors?

A. This Administration had the courage and foresight to look for skeletons in the defense closet, for problems that have plagued defense business for decades. One of Secretary Weinberger's first acts after coming to the Pentagon in 1981 was to hire additional auditors and create a position for an Assistant for Review and Oversight, a post that subsequently became the Inspector General of the Department of Defense. We hired 2,000 new auditors, inspectors and investigators. We have also created the Joint DoD-Justice Fraud unit to prosecute procurement fraud, waste and abuse; and recently concluded the most far-ranging audit in Department history. And these efforts are paying off:

- Criminal indictments of those attempting to defraud the government quadrupled from 1982 to 1983 and convictions doubled.
- In 1983 alone, our investigations led to nearly \$15 million in fines and recoveries and we obtained refunds from contractors of over \$1.5 million for overpricing.
- 323 contractors were debarred or suspended -- a five-fold increase over 1980.

The word is out that swindling the Defense Department doesn't pay. Meanwhile the Defense Department has instituted far-reaching management reforms to eliminate any opportunity for abuse or inefficiency in the future. The policies and procedures that have been put into place are not "quick fixes," but have been aimed at solving the long-standing problems of defense procurement and purchase of spare parts. The cycle of audit, reform, inspect and reaudit will continue until the Defense Department has tightened the procurement process to the point where the American taxpayer has every right to expect it to be.

Some of the problems uncovered by our reform efforts have been well-publicized as examples of Pentagon mismanagement. But often the full story is not told.

The Diode

What is generally known is that two diodes were bought at a price of \$110 each and that the same diode is (and was) available through the DoD supply system for four cents. Few accounts mention that DoD obtained a substantial refund, nor that 112,429 identical diodes were issued at the correct price (four cents each) to military customers during the eleven-month period ending February 1983.

The Claw Hammer

What the newspaper headlines say is that one common claw hammer was purchased at a price of \$436; some stories mention that the contractor paid a substantial refund; but what is never told is that thousands of Defense orders during the past year for common claw hammers were purchased at a price of roughly \$6.40 each.

The Allen Wrench

What is often claimed is that Defense was billed \$9,600 for one simple Allen wrench. What is generally not known is that this wrench was never purchased.

The Plastic Stool Cap

The now infamous \$1,118 navigator's stool cap was both over-engineered (requiring over 20 separate manufacturing steps) and bought in very limited quantities--3 in a two year period. It is generally known that an Air Force Sergeant found the problem, challenged the system and was rewarded. But seldom is it reported that the contractor refunded \$3,123 for previous purchases and located a supplier who can produce the parts inexpensively. The next time an AWACS crew chief needs a plastic stool cap, it will cost his unit 31 cents.

Part of the problem has been the method of distributing overhead costs. The claw hammer and diode were both purchased as parts of larger packages that included many other items. The inflated prices charged for these items, \$436 and \$110 respectively, included not just the price of the item itself, but the costs for engineering, manufacturing, storage, shipping, and associated overhead expenses. The contractors allocated these various overhead costs on a per item basis. Using this method, an equal overhead amount could be assigned to both a 4 cent diode and to a \$6,000 dollar mechanical assembly.

This method of distributing overhead costs was misleading and made it difficult to determine fair prices. New regulations in effect now require contractors to allocate their costs based on the quantity and intrinsic value of the item. Thus, a larger and more expensive item will now have a higher overhead charge than a smaller and less expensive one.

Other initiatives include:

- Requiring contractors certify to DoD that their prices are as low or lower than those charged to their "most favored customer."
- Restricting purchase of any spare part whose price has increased more than 25% in the last 12 months.
- Identifying vendors who can compete for future spare parts business.
- Increasing competition across the board--in FY 1980 the value of competitive awards was \$25.1 billion, last year it had jumped to \$47.8 billion.
- Increasing use of fixed price contracts--82% of all military procurement dollars last year were under fixed price contracts, up from 75% three years ago.

Our reforms are on-track--we're making sure we get the most out of each defense dollar spent.

- Q. The Defense Department continues to pay exorbitant prices for everything they buy, from spare parts to advanced fighter aircraft. Why don't they shop around to get better prices and instill some competition into their buying practices?
- A. Enhancing competition is a basic element of Secretary Weinberger's management reform program. The value of competitive awards in DoD jumped from \$25.1 billion in FY 1980 to \$47.8 billion by the end of FY 1983. In the same time period, the number of contracts awarded competitively jumped 1.1 million to a total of 5.5 million.

Key to the success in expanding competition is a recently established competition advocate program. Now an advocate is assigned to every buying command to challenge any purchase that appears to be non-competitive. Competition in aircraft spares has already tripled. And many new contracts for major systems include provisions requiring the contractor to provide the necessary data to seek second sources of supply in purchasing replacement parts. That ensures competition today as well as in the future.

All the Services are using competition to bring down prices:

- Rather than buy all spare parts from a single contractor, as in the past, the Army will require that at least 44% of the engine parts for its new experimental helicopter will be purchased competitively. It also will require contractors to relinquish proprietary rights on some parts after six years, so other companies can bid to supply replacement parts.
- In FY 1983, the share of Navy competitive contracts jumped from less than 30% to 40%. The Navy expects to increase the number of competitive actions to 50% or better this year.
- To promote continued competition between two major engine manufacturers, the Air Force split its recent contract for a new fighter engine, and awarded 75% of this year's new business to the contractor providing the best plan for future competition for spare parts.

Q. Why does the Pentagon punish whistleblowers?

A. Despite what you hear in the media, we reward them. As one example, the now-famous stool cap came to light because an alert Air Force sergeant at Tinker Air Force Base questioned the price tag of \$1100, and "blew the whistle" to the base office established to find such abuses. We obtained a full refund from the defense contractor and now buy that same plastic stool cap for 31 cents. The Air Force sergeant received a \$1,100 cash award for his whistleblowing.

In fact, we have provided a means for whistleblowers throughout the Defense Department to challenge questionable practices: the Department of Defense Hotline.

Since June 1981, when Secretary Weinberger officially revitalized the Hotline, over 20,000 calls and letters have been received--1/3 of which merited serious inquiry. Documented savings to date are over \$3.5 million.

We have given our employees incentives to use the Hotline. The first point of Secretary Weinberger's Ten Point spare parts program calls for bonuses and other rewards for employees who rigorously pursue cost savings or increased competitive bidding. Since the inauguration of the Ten Point program, nearly 400 defense employees have received over \$200,000 in cash incentives for earning the government many times that amount through their recommendations.

Q. We are constantly reading about cost overruns on "gold plated" weapons system. Why can't the Pentagon get these costs under control?

A. In fact, we have largely succeeded in making cost overruns a thing of the past. As reported recently by the Congressional Budget Office, annual cost growth, in current dollars, has dropped on a selected group of major weapons systems from 14% in 1980 to about 1% in 1983. More realistic budgeting, using independent cost estimates, and building competition into the procurement system are the primary reasons for the halt in cost growth. We are also promoting multi-year programs, improving program stability and seeking more economic production rates. Some results:

- The B-1B development program is ahead of schedule and within cost. Multi-year contracts on this program will save \$1.2 billion.
- In 1983, 8 of 21 ships delivered to the Navy were ahead of schedule, only one was late. Most were under cost, far different from the unpredictable record for shipbuilding in earlier years.
- In 1980 the Trident ballistic missile submarine was running months behind schedule and over cost. We turned that around and Trident submarines are now delivered 4-6 weeks ahead of schedule and under cost.

Q. Our weapons systems always seem to have something wrong with them, like the new M-1 tank that breaks down every few miles. Why doesn't the Defense Department get warranties on what they buy? Why did the Pentagon oppose congressional efforts to get warranties?

A. The M-1 tank is the finest tank we have ever built. Like all new items of equipment, it had some initial bugs that had to be worked out. One of those was in the transmission, and indeed the manufacturer honored the guarantees in the contract and repaired at no cost to the government all faulty transmissions.

Our objective for everything we buy is to ensure that DoD obtains the highest quality, most reliable military equipment, at the lowest cost to the taxpayer. Warranties play an important role in helping to achieve that objective, and that is why our contracts have included warranties for years.

Most recently, the Air Force negotiated a major aircraft engine contract that has a strong warranty--in fact, the warranty was an important factor in selecting the winning bid.

We intend to continue seeking such warranties whenever they make good sense. We do oppose, however, any legislation that forces us to pay for warranties that are not cost effective.

- Q. If it weren't for congressional cuts of the defense budget, Pentagon spending would be out of control. Why can't the Pentagon present a realistic budget?
- A. For the past 3 years we have presented a realistic, rational budget that is based on a careful assessment of the threat we face and the degree of risk we feel the nation can prudently accept. The budget increases of the past 3 years were designed to restore defenses that were weakened during the decade of the 1970's, when defense spending fell by 20% while entitlements increased about 120%. This year about 28% of the total federal budget goes for defense; in 1962 it was 49%. And this fiscal year the Pentagon budget is \$57 billion less than the Department of Health and Human Services.

Since last year, the President's original budget projections for defense have been cut back by \$75 billion. Additional cuts mandated by congressional action have delayed rebuilding our defenses, forced uneconomic program stretch-outs and, in some cases, perpetuated "pork barrel" projects that were neither requested nor necessary.

Further cuts in defense spending this year would undermine the progress of the last three years, interrupt the momentum we have built up in restoring America's defense and mark a return to the disastrous defense spending patterns that so weakened our deterrent capability in the past 1970's.

- Q. A House committee staff report claimed that despite the billions we have spent for defense over the past four years, readiness has declined. How can this be true?
- A. It is not. The House report is a year old and was based on data reflecting conditions a year before that. Since it takes at least two years between the obligation of funds and delivery of equipment to the field, the report was bewailing inadequate supplies ordered during the previous administration. It confirms what we have been saying all along--that the neglect of the 1970's seriously undermined our readiness.

Fortunately, those conditions are being rectified by the readiness investments of the past 3 years. Today, as the Chairman of the Joint Chiefs of Staff, General John Vessey, recently stated: "We have better people, they're armed with better equipment, their training has been improved, and they have better support behind them. And that makes a readier force."

- Q. Is it true that if we had to go to war today, our troops would run out of bullets and gas within a few days? Is it true that we could not defeat an attack in Europe with conventional weapons, and that we would have to resort to nuclear weapons within a week or so?
- A. It is not true that our troops would run out of ammunition and gas within a few days. However, it is true that in 1981, because funding levels in previous budgets were often insufficient, we were very concerned about our ability to sustain our forces in combat on a large scale at high intensity. Since 1981, we have made significant progress in rebuilding our stocks by funding large increases in ammunition and by improving the flow of logistics to our deployed units. By the time our purchases are delivered to the field, sustainability will have increased by over 50%.

Q. The Defense Department is getting ready to launch another arms race with its Star Wars Program. Won't this violate the ABM treaty, provoke the Soviets, and bankrupt the country in the process? How do we know such a scheme will work?

A. The Strategic Defense Initiative is not in violation of the ABM Treaty. It is a program that holds great promise for improved opportunities for genuine arms reductions. The Strategic Defense Initiative is a research program designed to identify options for building a thoroughly reliable defense against ballistic missiles, options that will permit a future President to decide how best to create a safer world free from the threat of nuclear missiles.

While we do not know how much an effective defense based on these new technologies might cost, our technical experts are confident that new technologies offer the promise of defensive systems that are cheaper than the cost of overcoming them. This would fulfill President Reagan's vision of rendering offensive nuclear missiles obsolete. Thus the Strategic Defense Initiative could enable us to reduce future spending on offensive arms, to strengthen deterrence, to improve prospects for arms reductions, and, in the end, make possible a surer and safer peace.